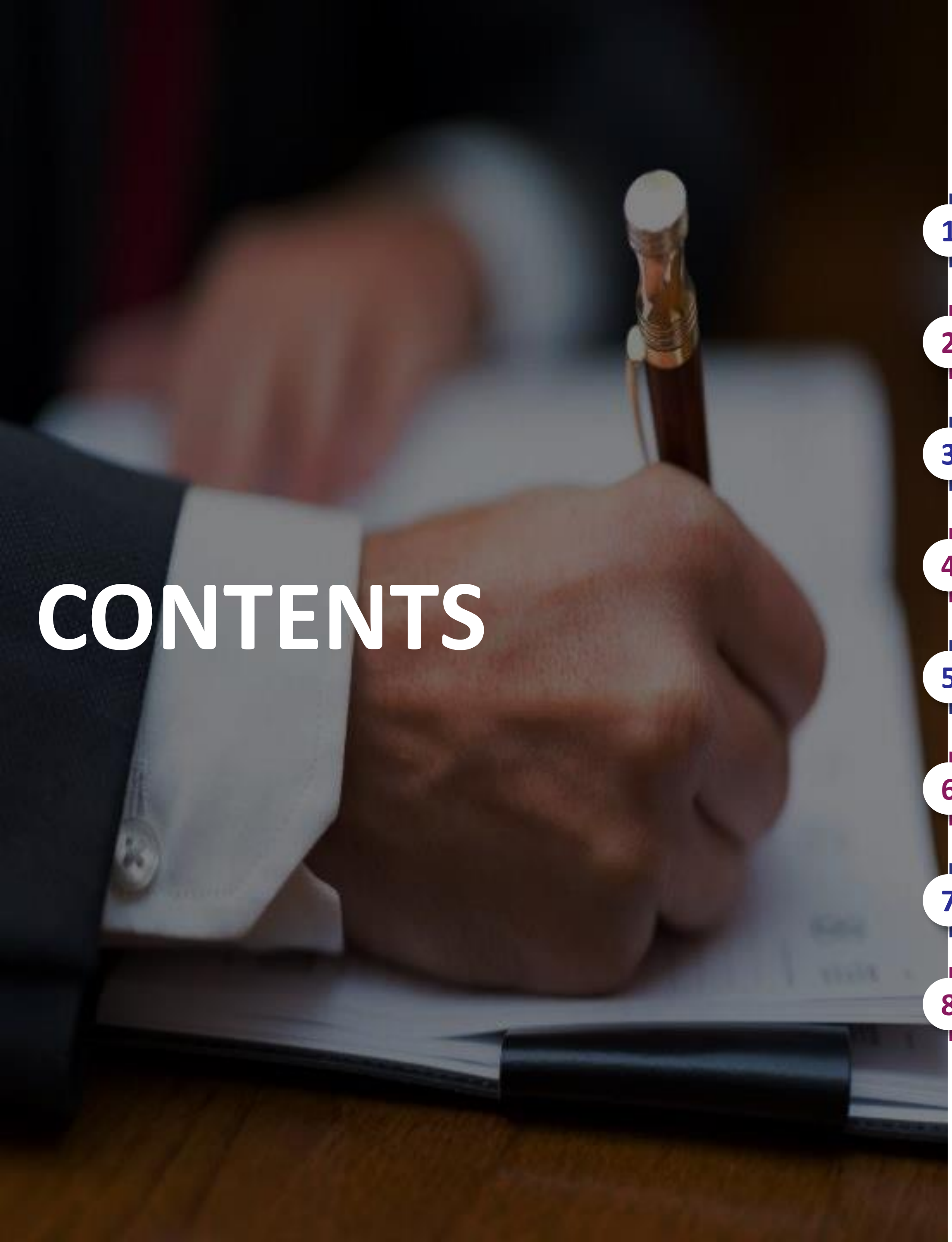
SBICAPS
Complete Investment Banking Solutions

# RBI MONETARY POLICY

## TAKING GUARD AGAIN: PLAYING TO KEEP THE LOCAL WEATHER CLEAR AND SUNNY

07 June 2024



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# EXECUTIVE SUMMARY (1/2)

**MPC maintains status quo on rates and stance, both by a 4-2 vote (vis-à-vis 5-1 in the last policy)**

In line with expectations, policy rates were kept unchanged, with the Repo at 6.50%, with the stance retained as "withdrawal of accommodation." Shifts in voting patterns suggest a growing cohort within the MPC advocating for evolution of policy discourse. Ongoing transmission to lending rates, last mile of disinflation, and disjointing the stance and liquidity conditions support these decisions. Thereby, ***we anticipate the first rate cut only in late CY24, as the RBI plays according to the local weather (ensuring disinflation and sustaining growth) while keeping an eye on the global horizon***

**Focus remains on preserving financial stability while anchoring inflation expectations**

The confluence of effective monetary and fiscal policies led to a stellar real growth of 8.2% y/y in FY24. The economy is at an inflection point and materializing of the upwardly revised real growth projection of RBI of 7.2% (previous: 7.0%) in FY25 would mark 4th consecutive year of 7%+ growth. With enhanced fiscal buffers bolstered by RBI dividend amidst varying expectations from fiscal policy, expected agricultural recovery due to favourable monsoons, and anticipated pick-up in manufacturing capex as well as global trade, **our confidence on FY25 real GDP forecast of 7% y/y grows.** This robust growth is expected to support continued fiscal consolidation, with the fiscal deficit already narrowing to 5.6% of GDP in FY24, better than FY24RE

**Effective monetary policy sets the stage for bringing inflation down at keeping it there durably**

Stable inflation, aided by an ebbing Core, favourable base effects, bountiful monsoons, and moderating crude, aligns with the RBI maintaining previous projection of headline CPI averaging 4.5% y/y in FY25 (**our forecast: 4.7%**). Transitory shocks in food due to production and sowing patterns, particularly affecting TOP and pulses, warrant close monitoring. *Separately, the RBI Governor was categorical that the inflation should not only decelerate but must remain there durably*.

**Conscious and nimble liquidity management and counter-cyclical measures garner focus of policyspeak**

The liquidity situation is dynamic with LAF operations at multi-year highs. Once fiscal spending gains traction, with bond inclusion flows starting this month, the situation is expected to be calibrated more judiciously. Maintaining the WACR proximate to the midpoint of the corridor whilst enhancing the efficacy of monetary transmission continues to be a central objective. Additional counter-cyclical measures including higher contingency fund of RBI, proposing higher provisioning norms for project finance, raising risk weights for unsecured loans, and building tall forex buffers safeguard against financial shock.

**Financial system continues to remain resilient; judicious use of regulatory freedom by the financial sector is required**

While being eloquent about the resilience of financial ecosystem, reflected in strong balance sheets and enhanced asset quality, the Governor warned that the interest rates on small value loans are high and appear to be usurious in some MFIs and NBFCs. The importance of safeguarding customer interests was reiterated.

# EXECUTIVE SUMMARY (2/2)

**RBI builds sufficient forex buffers to keep the local weather sunny and external sector resilient**

In FY24, CAD narrowed to ~1% of GDP, propelled by robust remittances and service exports, amidst the rapid expansion of GCCs. Despite recent FPI outflows and a moderation in net FDI, India remains an attractive destination for capital inflows. *Confidence in managing external financing needs is underscored by record-high forex reserves of USD 651 bn*, further bolstered by growth in ECB agreements, non-resident deposits, and potential bond inclusion flows. Due to above mentioned factors, the impact of US Fed monetary actions on India's resilient external sector and economic growth seems limited.

**Key additional measures**

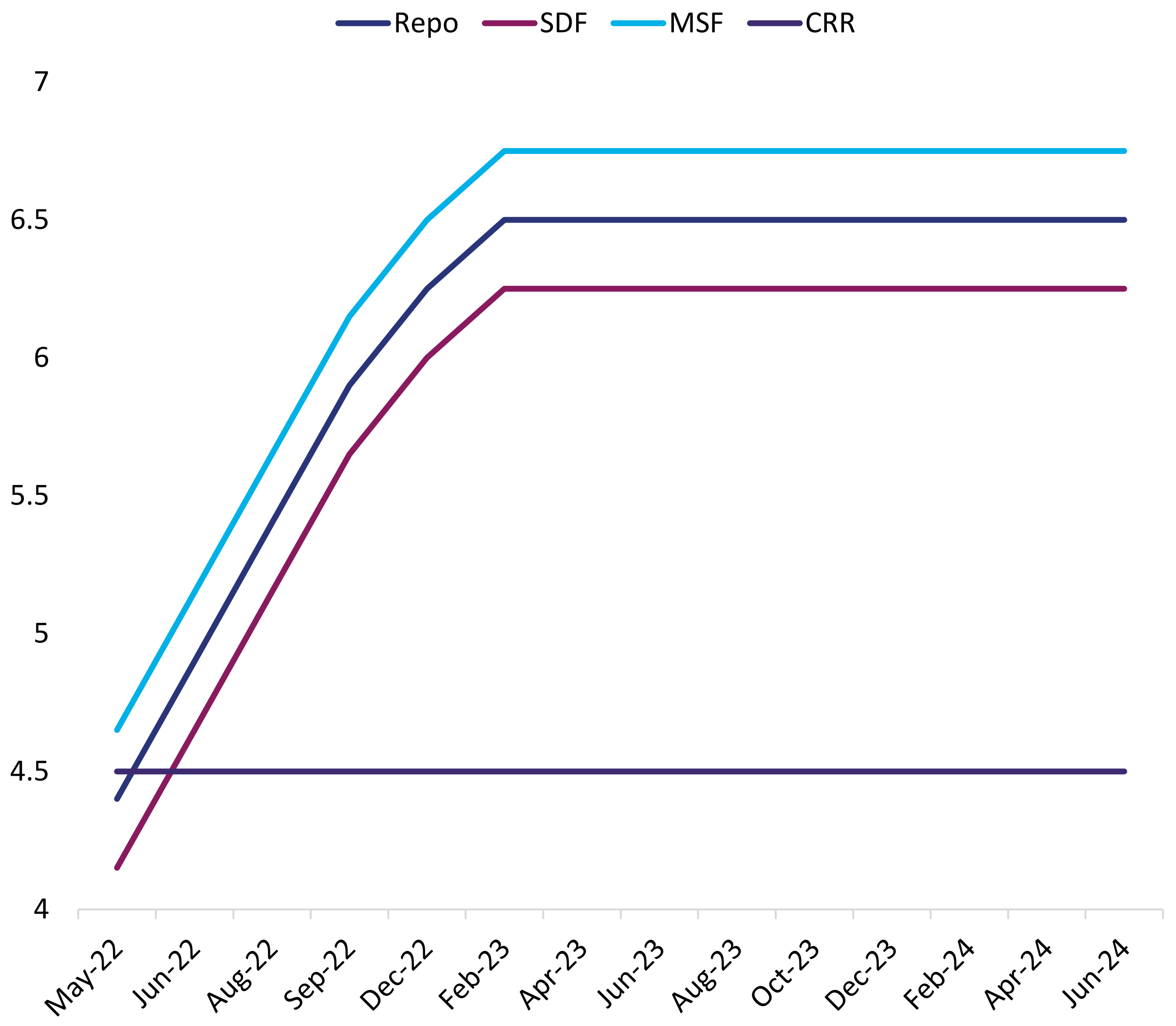
- Review of limit of bulk deposits – upwardly revising the definition to Rs. 30 mn for SCB (excluding RRB) and SFB and Rs. 10 mn for RRB and local banks
- Rationalisation of guidelines for export and import of goods and services under FEMA to promote ease of doing business
- Setting up a digital payments intelligence platform- real-time data sharing across the digital payments' ecosystem to ensure safety and security

**With RBI committed to domestic narrative, G-Sec yields remained range bound**

Status quo policy kept the yields range bound, with the 10Y Union G-sec remaining at last trading session's level of 7.01%. Noteworthy, RBI remains steadfastly committed to the domestic narrative, explicitly stating that actions of US Fed might not warrant RBI following suit. Global monetary easing, continued fiscal consolidation, bond inclusion flows, cooling inflation, and anticipated rate cuts after late CY24, ensure the ***continued descent of 10-year yields below 7% over the medium term.***

# RBI KEEPS POLICY RATE AND STANCE UNCHANGED AS EXPECTED

## KEY RATES (%)




## STANCE OF POLICY

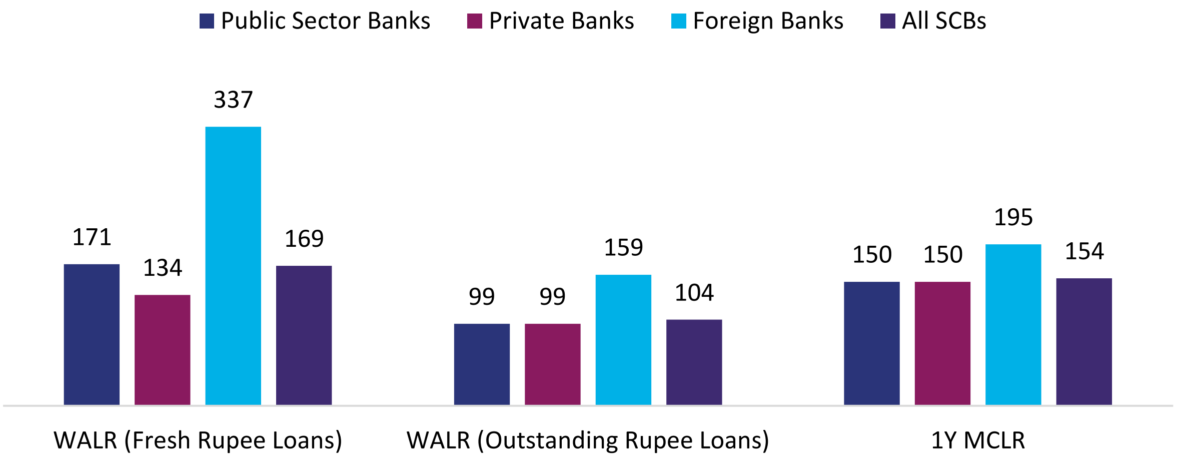
| Date | Stance | Vote |
|---|---|---|
| 04-May-22 | Remain accommodative, while focussing on withdrawal of accommodation | 6-0 |
| 08-Jun-22 | Withdrawal of Accommodation | 6-0 |
| 05-Aug-22 | Withdrawal of Accommodation | 6-0 |
| 30-Sep-22 | Withdrawal of Accommodation | 5-1 |
| 07-Dec-22 | Withdrawal of Accommodation | 4-2 |
| 08-Feb-23 | Withdrawal of Accommodation | 4-2 |
| 06-Apr-23 | Withdrawal of Accommodation | 5-1 |
| 08-Jun-23 | Withdrawal of Accommodation | 5-1 |
| 10-Aug-23 | Withdrawal of Accommodation | 5-1 |
| 06-Oct-23 | Withdrawal of Accommodation | 5-1 |
| 08-Dec-23 | Withdrawal of Accommodation | 5-1 |
| 08-Feb-24 | Withdrawal of Accommodation | 5-1 |
| 05-Apr-24 | Withdrawal of Accommodation | 5-1 |
| 07-Jun-24 | Withdrawal of Accommodation | 4-2 |

- RBI’s MPC kept the repo rate unchanged at 6.50%, in line with market expectations, and the stance was retained at withdrawal of accommodation
- **Vote split changed to 4-2 from 5-1 in the last policy** - this suggests a growing cohort within the MPC advocating for evolution of the policy discourse

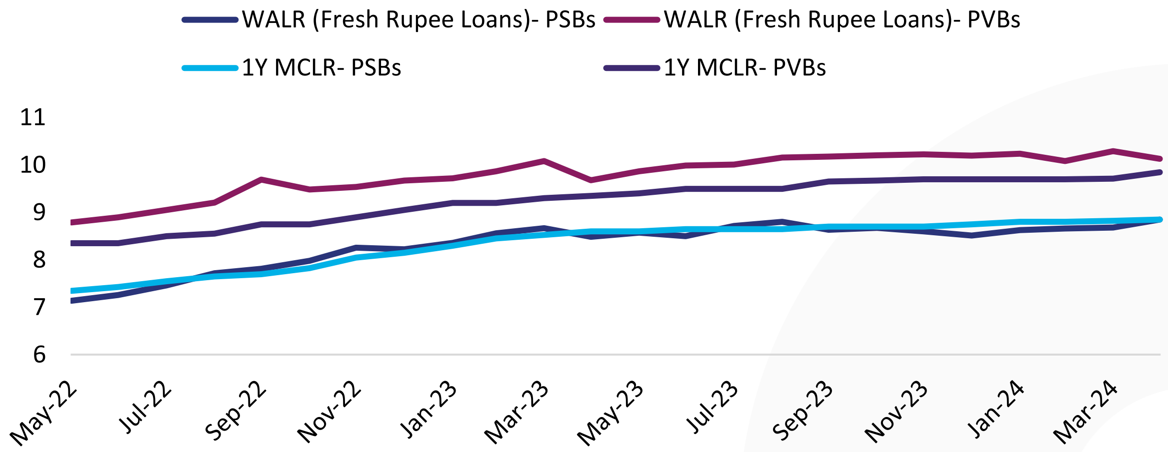
*Source: RBI, SBICAPS*

# RATE TRANSMISSION REMAINS A WORK-IN-PROGRESS

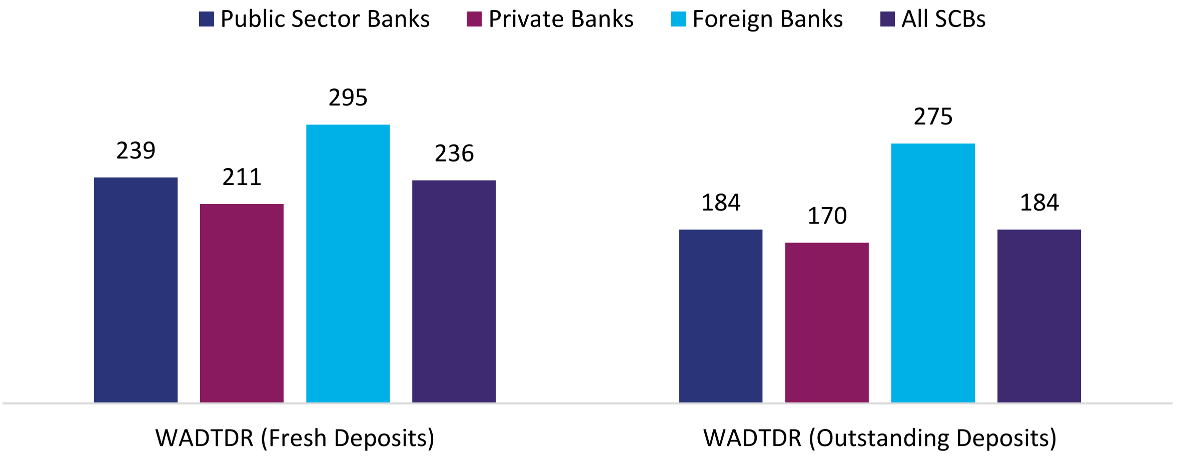
## TRANSMISSION TO LENDING RATES FROM MAY’22 TO APR’24 (BPS)




## LENDING RATES OF DOMESTIC BANKS (%)




## TRANSMISSION TO DEPOSIT RATES FROM MAY’22 TO APR’24 (BPS)



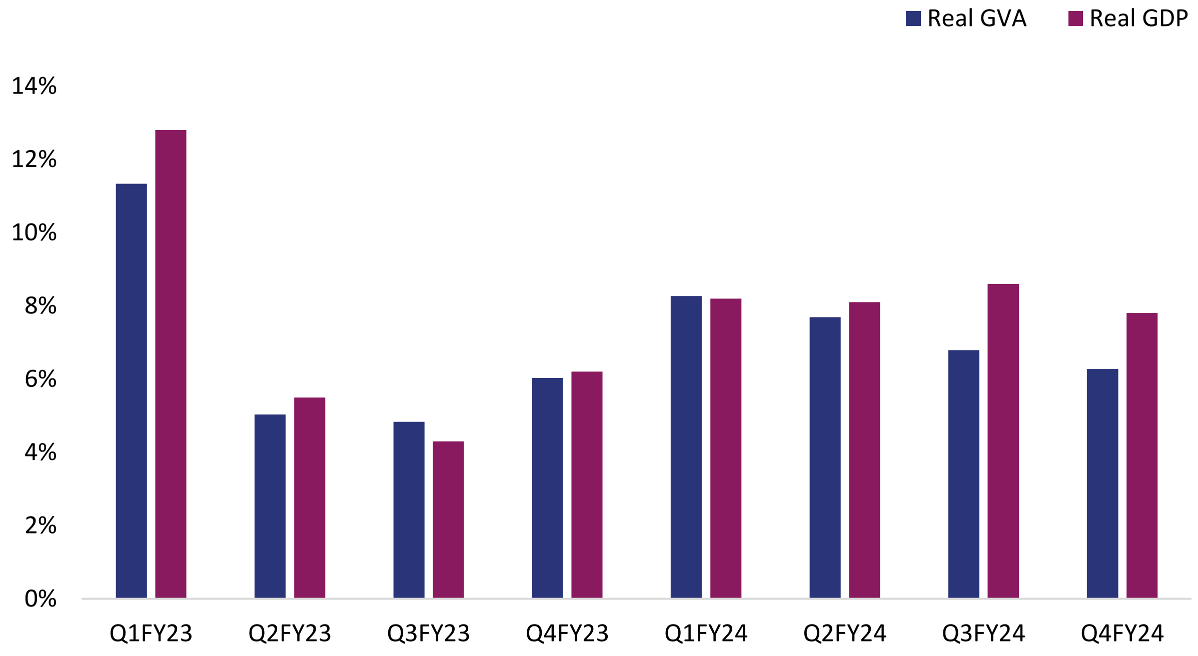

- 250 bps of rate hikes have not been fully transmitted to lending rates. This assumes importance as RBI remains steadfast in its resolve to ensure transmission of past policy actions

- Transmission to deposits is more complete. Even so deposit growth is not able to match up with credit growth

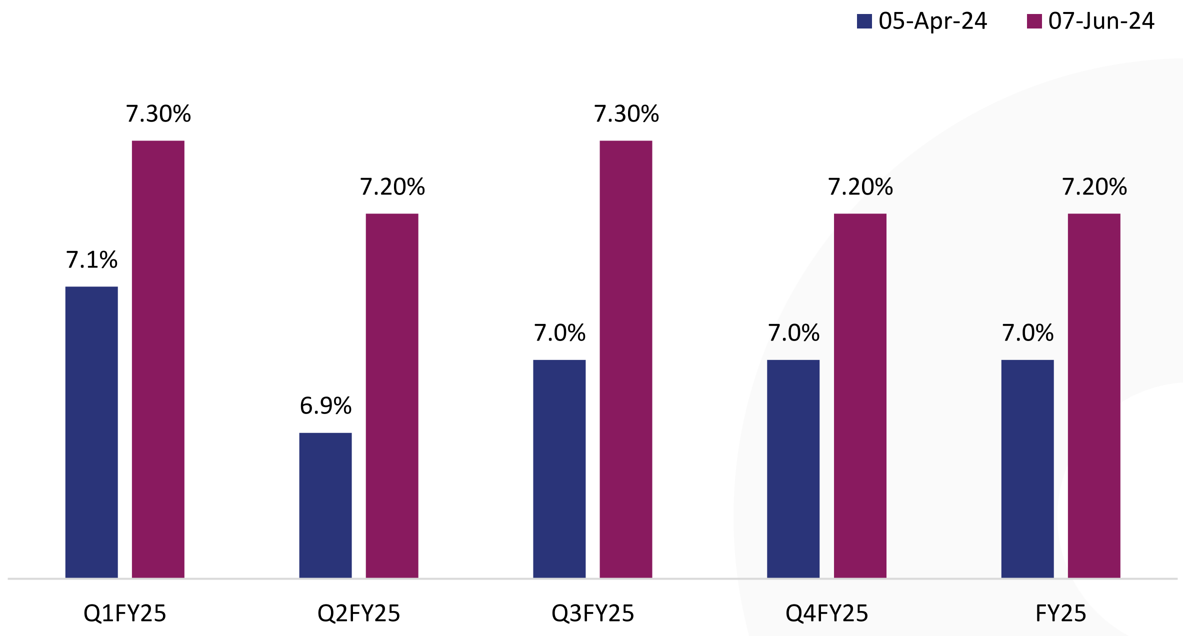
*Source: RBI, SBICAPS*

# DOMESTIC BUOYANCY AMID CHANGING GLOBAL GROWTH NARRATIVE

## QUARTERLY REAL GDP & GVA GROWTH RATES (Y/Y)



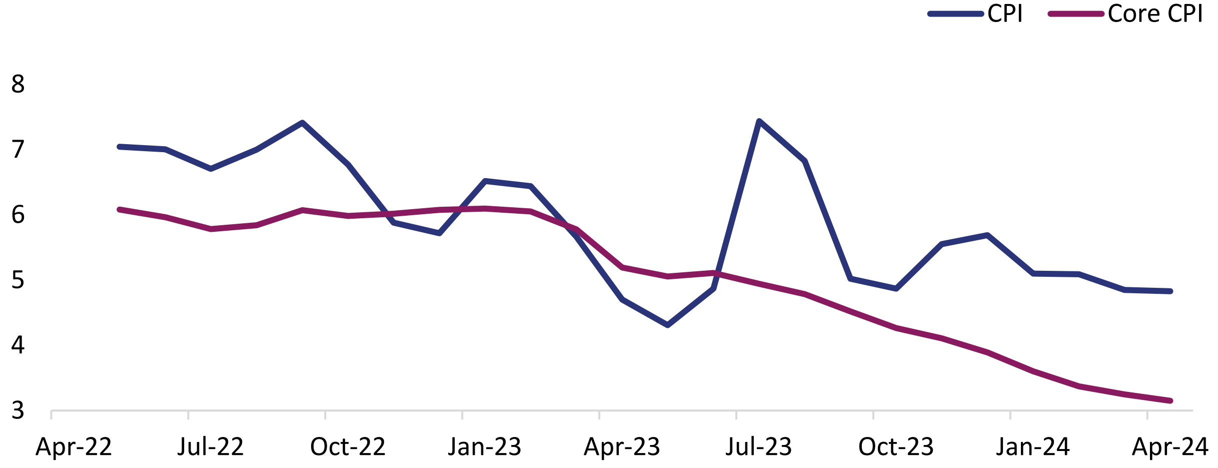

## PROJECTED REAL GDP (Y/Y) AS PER RBI



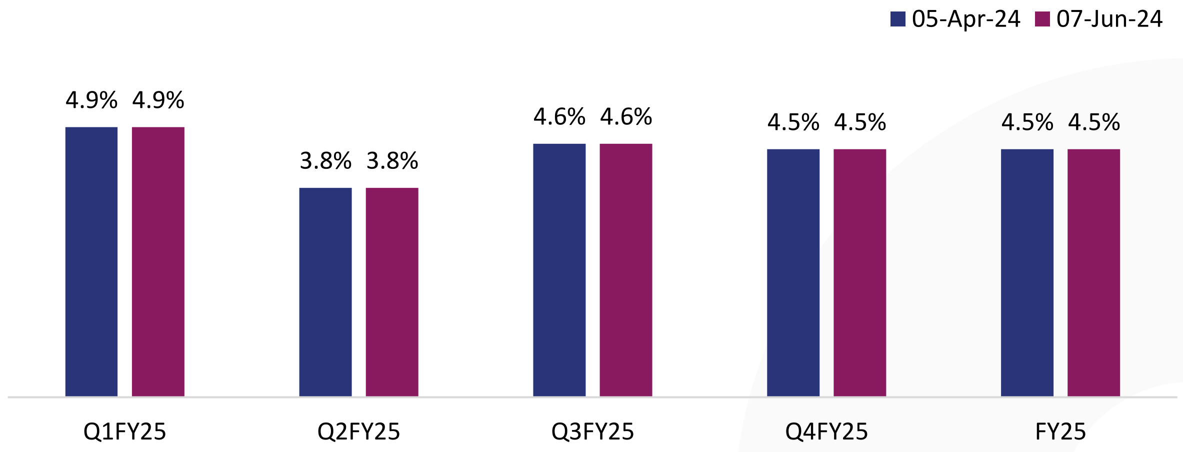

- Global growth appears to be on a stronger footing than earlier thought and India continues to beat all expectations. RBI revised domestic real growth projection upward by 0.2 pp to 7.2% y/y for FY25, with upward revisions across the quarters.
- ***For FY25, the outlook is better than before, and we remain confident on our estimated real GDP forecast at 7.0% y/y***, marking 4$^{th}$ consecutive year of 7.0%+ growth. This upward revision is based on improved spending buffers of the Union, expectation of revival in private manufacturing capex, and rebound in trade with fewer global clouds on the horizon

## RBI COMFORTABLE WITH EBBING CORE

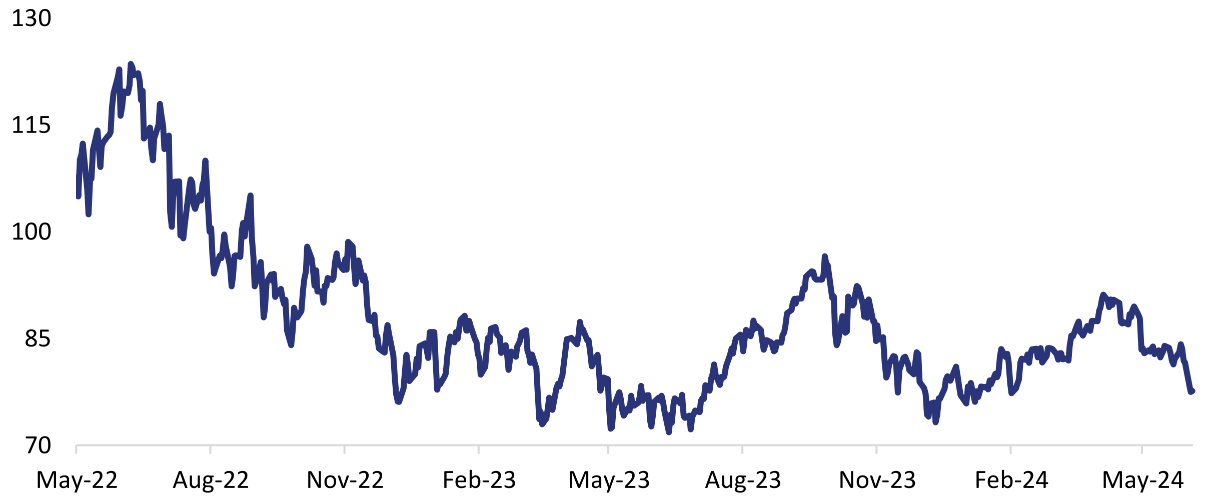
### CPI AND CORE CPI (% Y/Y)




### PROJECTED CPI (Y/Y) AS PER RBI




### BRENT CRUDE (USD/BBL)

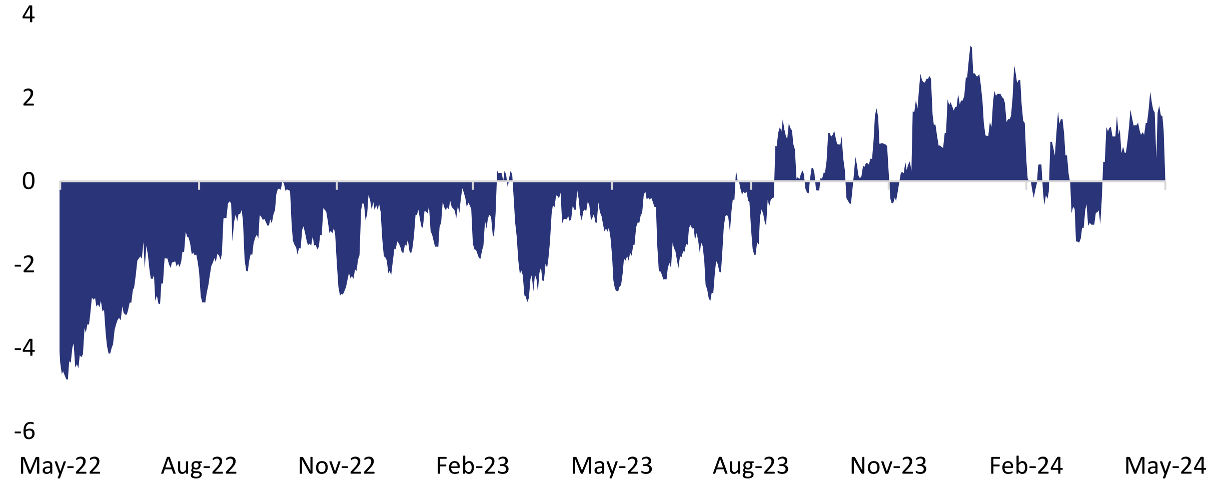



- RBI maintained its inflation expectations of FY25 at 4.5%, while projecting inflation to lower gradually and then increasing again in later quarters
- The Governor in the press conference categorically mentioned that inflation must not only decline to the target but must durably remain there
- Amid significant progress in ebbing Core, inflation doesn't seem to be pose a quandary for MPC anymore. Expectation of above average monsoons and flattish oil prices will also support food and fuel inflation respectively

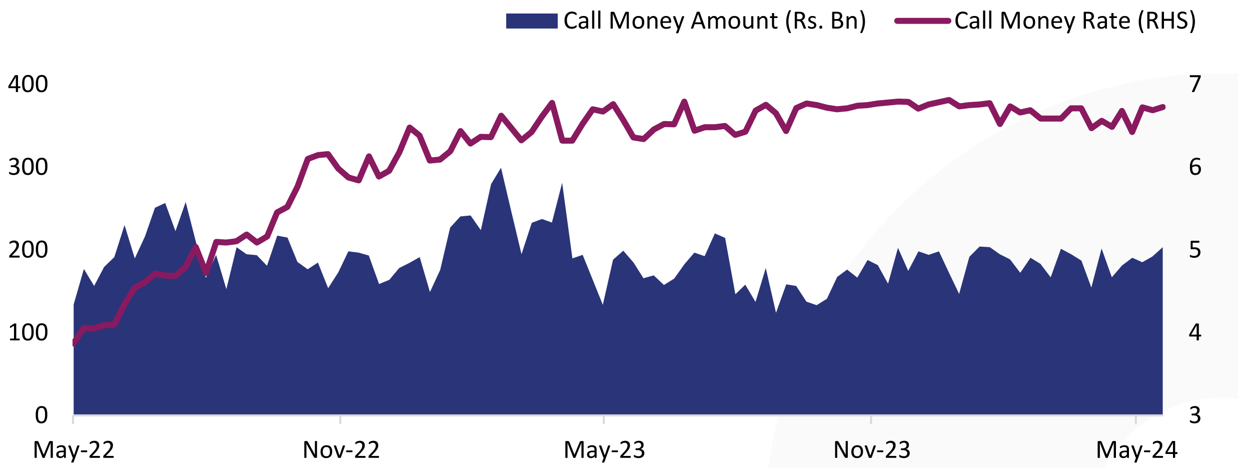
*Source: Bloomberg, RBI, SBICAPS*

# RBI FOCUSSES ON NIMBLE LIQUIDITY MANAGEMENT

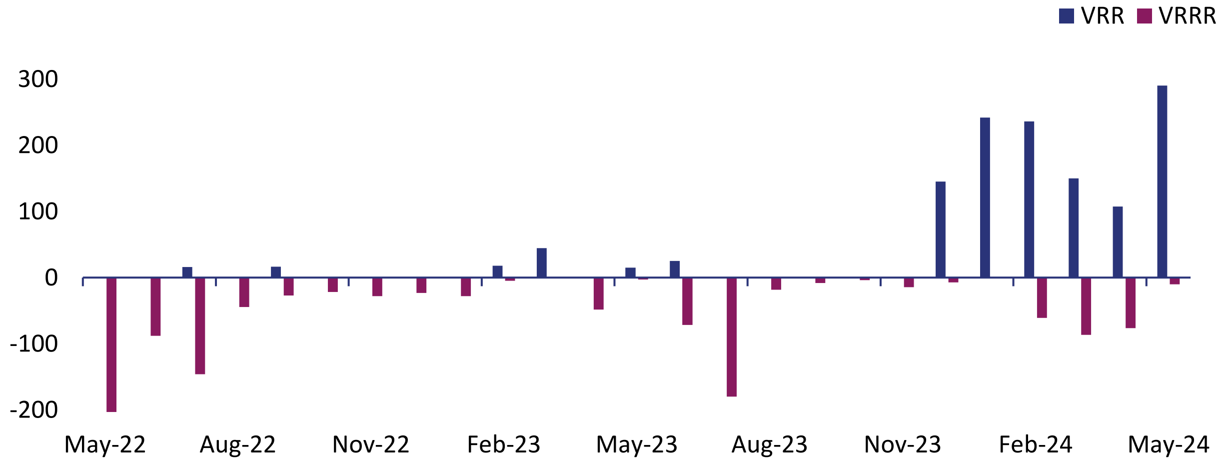
## BLOOMBERG INDIA LIQUIDITY INDICATOR (Rs. trn.)




## CALL MONEY AMOUNT (Rs. bn.) VS CALL MONEY RATE (%)




## DAILY AVERAGE VRR AND VRRR OPERATIONS (Rs. bn.)*




- Liquidity currently stands at a minor surplus in Jun’24, led by LAF operations at multi-year highs and G-Sec buybacks, evidencing the commitment of apt flexible and durable liquidity by RBI, exhibited through the softening bias in WACR, making it stable
- Resumption of Union spending after the formation of government is expected ease liquidity, leading to more calibrated calibrations by the RBI

Source: Bloomberg, RBI, SBICAPS; *Data until 26 May’24

# STRONG MACROS DRIVE VOLATILITY IN US YIELDS

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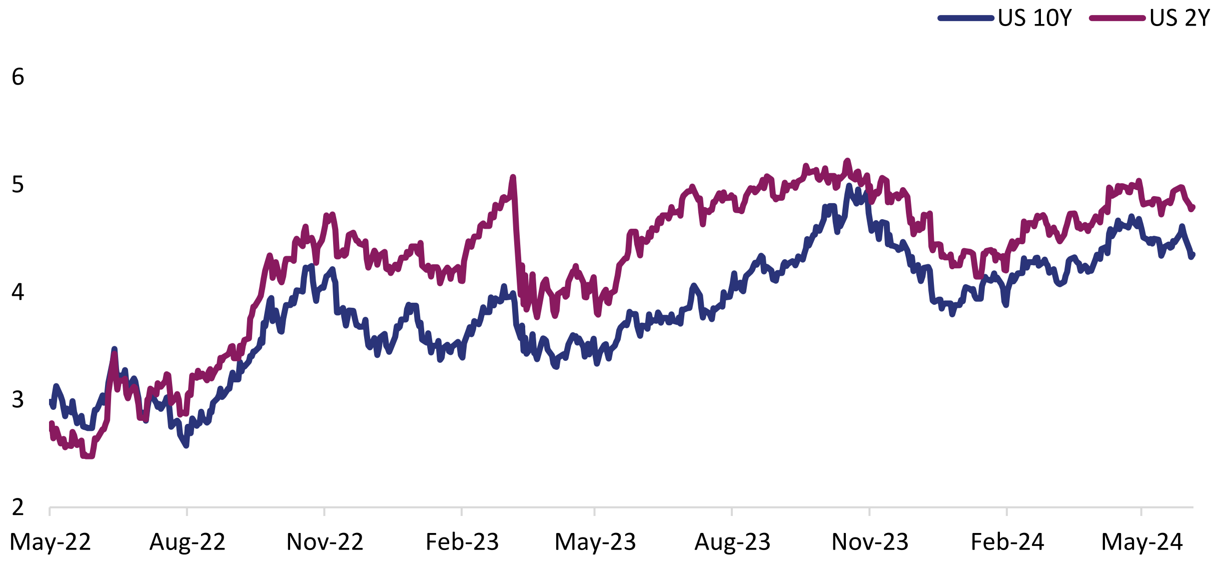
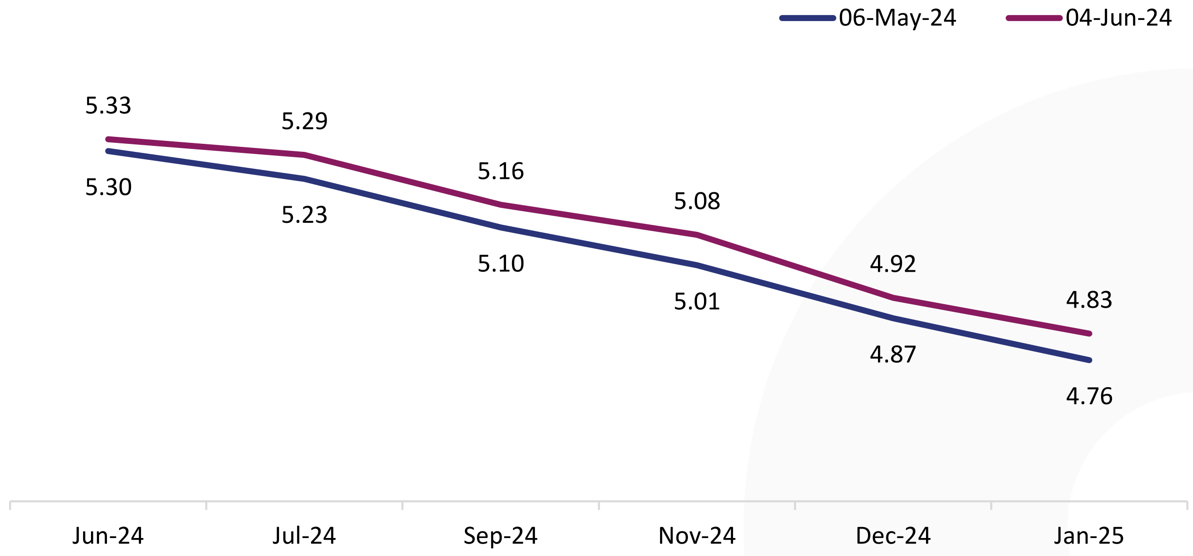
## US G-SEC YIELDS (%)




## MARKET-IMPLIED PATH OF US FED POLICY RATE (IN %)

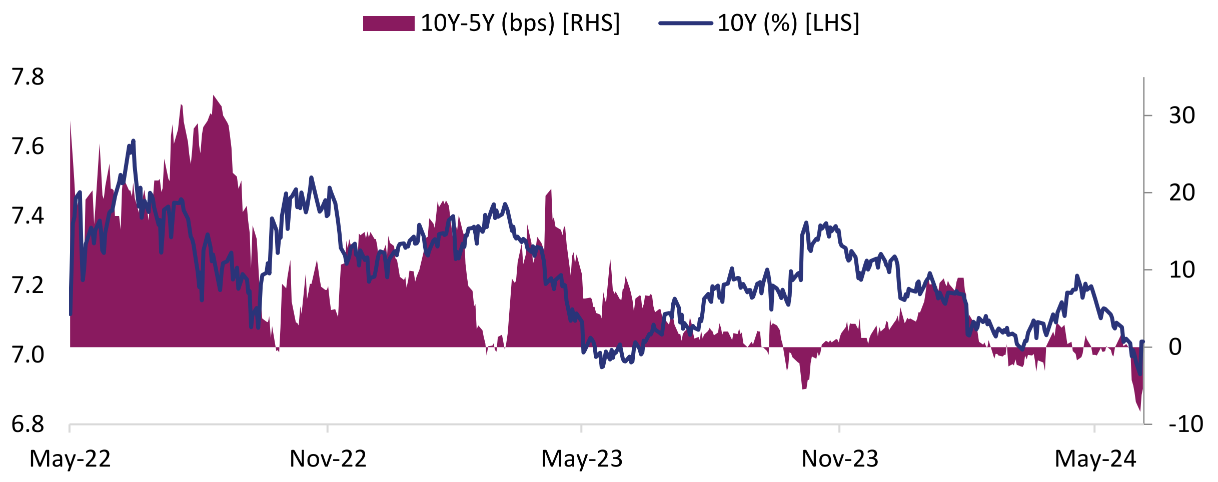



- US bond yields continue to remain volatile, with market expectations oscillating between 1-2 cuts by end of CY24. Contemporarily, the confluence of labour markets losing steam amid policymakers repeatedly being wary of a stalled progress on disinflation is driving the market narrative
- The impact of global bond price volatilities is not expected to be acute on domestic market. However, recently the rally in domestic bond prices was interrupted by prospected political uncertainty. RBI remains steadfastly committed to domestic narrative, as explicitly stating that even if US Fed were to ease its policy, RBI might not follow suit

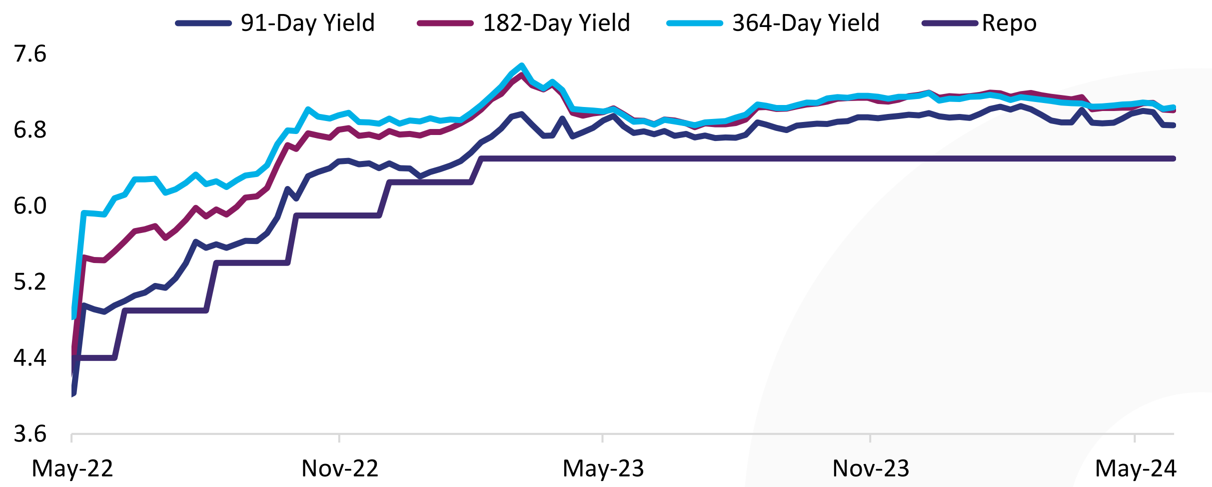
*Source: Bloomberg, SBICAPS*

# INDIAN YIELDS REMAIN STABLE DESPITE GLOBAL VOLATILITIES

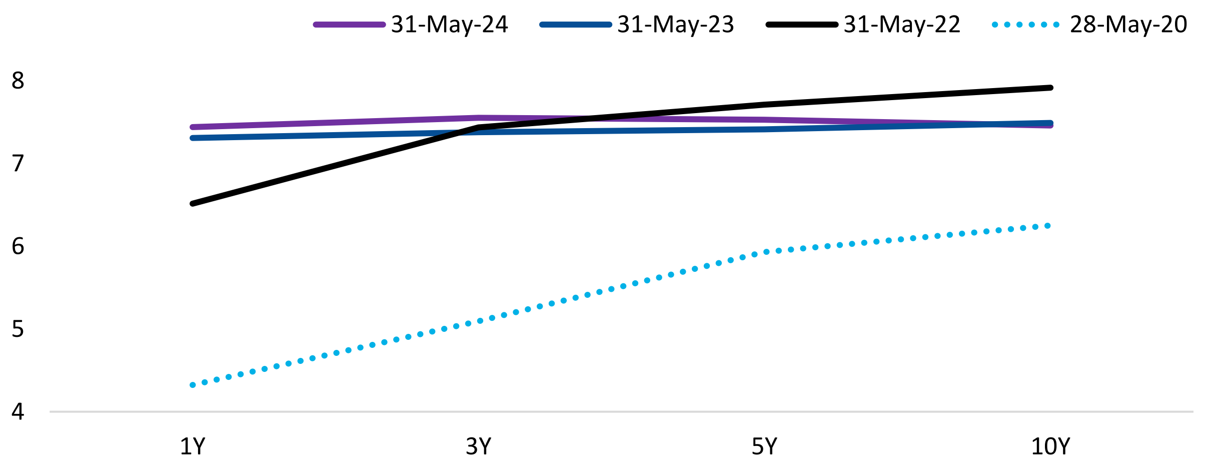
## G-SEC YIELD VS. 10Y-5Y G-SEC SPREAD




## T-BILL YIELDS VS. REPO (%)




## EVOLUTION OF YIELD CURVE (IN %)




- Despite widely oscillating US 10-year yields over the past couple of months, Indian yields have largely remained stable. 10-year yield expected to resume its descent below 7%, despite minor blips
- Mild inversion in 5–10-year range and a flattish curve are expected to reverse once RBI alters its policy

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**Details of Research Analysts**

| | | | | | |
|---|---|---|---|---|---|
| Name | Rajan Jain | Name | Venkatesh Balakrishnan | Name | Vansh Gupta, CFA, FRM |
| Qualification | PGDBA | Qualification | PGDM | Qualification | MBA |
| Designation | Head- Credit Research | Designation | Assistant Vice President | Designation | Deputy Manager |

**Details of Research Analyst entity**

| | |
|---|---|
| Name | SBI Capital Markets Limited |
| Registration Number | INH000007429 |
| Address | 15th floor, A & B Wing, Parinee Crescenzo Building, G Block, Bandra Kurla Complex, Bandra East, Mumbai- 400 051 |
| Telephone Number | +91 22 4196 8300 |
| Compliance Officer | Bhaskar Chakraborty |
| Email id | compliance.officer@sbicaps.com |
| Telephone Number | +91 22 4196 8542 |

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